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No. 76-425

In the Supreme Court of the United States

OCTOBER TERM, 1976

FRANK J. AND GRACE P. SAIA, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

ROBERT H. BORK,
Solicitor General,
Department of Justice,
Washington, D.C. 20530.

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Petitioner[1] challenges the decision in this federal income tax case holding that certain loans made by him were nonbusiness loans that had not become totally worthless during the year in issue and were therefore not deductible under Section 166 of the Internal Revenue Code of 1954 (26 U.S.C.).

The pertinent facts are as follows: Petitioner was the president and major shareholder of Saia Electric, Inc., a corporation engaged in the electrical construction and contracting business in Baton Rouge, Louisiana. Petitioner also made numerous personal investments in the securities of other corporations (Pet. App. B 12-13).

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[1]Petitioner refers to Frank J. Saia. Grace P. Saia is a party because she filed a joint return with her husband for the year in issue.

In 1968, petitioner advanced $68,500 to Ty-Mac, Inc., a corporation engaged in the electrical outdoor sign business in Las Vegas, Nevada. The parties treated $65,980 of this amount as a loan and the remaining $2,500 as the purchase price for a 32-percent capital interest in Ty-Mac. Ty-Mac made payments on the loan through October, 1969 (Pet. App. B 13-14).

In 1970, petitioner became concerned about the ability of Ty-Mac to repay his advances and began an investigation of the corporation. The persons petitioner employed to conduct this investigation recommended that he force a sale of the corporation's assets as a means of obtaining repayment of the debt. No sale was effected, however, and Ty-Mac continued in business through 1971 (Pet. App. A 14-16).

In 1972, petitioner sold his debt and equity interests in Ty-Mac to one of its officers for $3,000 in cash, plus the officer's note for $22,000. On his 1970 tax return, petitioner claimed a business bad debt deduction of $63,107.85, claiming that his loan to Ty-Mac became worthless in that year (Pet. App. B 13, 16).

The second loan at issue arose out of petitioner's acquaintance with two men who were shareholders and officers of Capital City Communications, Inc., which owned a radio station in Baton Rouge. Petitioner guaranteed a $20,000 loan made to these two officers of that corporation and they used the loan proceeds to purchase the remaining stock interests from Capital City's other shareholders. In 1970, petitioner was called upon to honor his guarantee, and petitioner sought reimbursement from the borrowers (Pet. App. B 17).

He and they entered into a series of transactions, which resulted in petitioner's ownership of all the Capital City stock previously owned by the two shareholders, for which petitioner paid $4,000 to one of them.

Petitioner had the Capital City stock registered in the name of his son-in-law. On his 1970 tax return, petitioner deducted his $20,000 guarantee payment as a business bad debt (Pet. App. B 13, 16-18).

On audit, the Commissioner of Internal Revenue determined that petitioner's debts were nonbusiness debts and that, in any event, petitioner had not established that they had become worthless during 1970 (Pet. App. B 12). The Tax Court found that petitioner's dominant motive in making the loan to Ty-Mac and the guarantee to the shareholders of Capital City was to further his personal interests, rather than his "trade or business" interests as an employee of Saia Electric. It therefore held that the loans were nonbusiness debts under Section 166 (d) of the Code. However, the Tax Court further found that the debts had not become worthless during 1970 so that petitioner was not entitled to any bad debt deduction for that year (Pet. App. B 11-29). The court of appeals affirmed *per curiam* (Pet. App. A 10).

1. In *United States* v. *Generes*, 405 U.S. 93, this Court held that losses resulting from loans will qualify for the Section 166(a) deduction against ordinary income for business bad debts only if the making of the loan was dominantly motivated by the taxpayer's trade or business. Here, the Tax Court correctly held that petitioner's dominant motivation for making the loans in question was to enhance his personal gain and not his trade or business as an employee of Saia Electric. The loans were primarily an outgrowth of petitioner's investment activities, and were therefore nonbusiness loans which, if worthless, would only have been deductible as short-term capital losses. See Section 166(d); *United States* v. *Generes, supra; Whipple* v. *Commissioner*, 373 U.S. 193.

2. The Tax Court also correctly held that petitioner failed to prove that his Ty-Mac loan and the loan to the Capital City shareholders had become totally worthless during 1970. An unrelated party had offered to purchase Ty-Mac's assets in that year and, as the Tax Court found, Ty-Mac remained in business after 1970 and petitioner had valued the Ty-Mac indebtedness at $30,000 on a personal financial statement in June, 1971. Indeed, petitioner's claim of worthlessness in 1970 is decisively refuted by his sale of the Ty-Mac obligation and stock interest in 1972 for $3,000 in cash and a $22,000 note (Pet. App. B 25-26).

With respect to his guarantee to the Capital City shareholders, petitioner received the debtors' stock in Capital City in satisfaction of the debt. But since petitioner paid $4,000 in cash in addition to releasing his claims under the $20,000 guarantee at the time the stock was transferred to him, the stock was obviously worth more than the guarantee payment petitioner had made. The record amply supports the Tax Court's decision that neither of these debts became wholly worthless in 1970.[2]

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

NOVEMBER 1976.

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[2]Petitioner also contends (Pet. 7-8) that the alleged loss on his guarantee payment of the loan to Capital City's shareholders qualified for treatment as a business bad debt under Section 166(f). While this point was argued in the Tax Court, petitioner abandoned it in the court of appeals. Accordingly, petitioner may not raise it here. Cf. *Helvering* v. *Wood*, 309 U.S. 344, 348-349. At all events, the loan petitioner guaranteed was not used in the trade or business of the Capital City shareholders, as required by Section 166(f). Rather, the loan proceeds were used by them for "nonbusiness" investment purposes (see Pet. App. B 27-28).

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